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BRIEF ON THE HOUSING MARKET OUTLOOK FOR TENNESSEE
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Home sales

The housing market is still robust in Tennessee, as indicated by volume of home sales and average price levels. From 2005 to 2006, the number of homes sold increased by 2.2 percentage points, while the average sales price increased by 8.6 percentage points. More recently, however, there has been a cooling off in the housing market. From the first quarter of 2006 to the first quarter of 2007, average prices increased by 3.1 percent and home sales declined by 5.4 percent.

Some regions of Tennessee are seeing recent inventory increases in residential buildings for sale, as shown below:

No. of Residential Listings in	**June 2006**	**June 2007**
Greater Nashville Assoc. of Realtors	11,061	14,564
Memphis Area Assoc. of Realtors	9,832	12,363

Even though this signals a slowdown in home sales, the number of building permits indicates that inventory buildup might soon decrease. According to the Census Bureau, in June of 2007 there were fewer permits issued (2,532 permits) compared to June of 2006 (3,488 permits).

Serious Delinquency
The most recent national delinquency survey from the Mortgage Bankers' Association (MBA) shows the following for all Tennessee loans by surveyed bankers:

	Total No. of Loans	No. Seriously Delinquent	Pct.
1st Quarter, 2007	819,657	22,131	2.7%
1st Quarter, 2006	771,714	20,296	2.63%

Seriously delinquent is defined as 90 days and more delinquent plus foreclosure inventory at the end of the quarter. The most recent Tennessee rate of 2.7% compares favorably with the overall rate for the East South Central states (2.86%), but is higher than the national average of 1.93%. These relative positions were the same in the first quarter of 2006.

Subprime ARMs
The rapid rise of subprime Adjustable Rate Mortgages (ARMs) peaked in 2005 and resulting rate adjustments are forthcoming in the next few years. In Tennessee, as of April 2007, 63,610 subprime loans that were originated between 2004 and 2006 remained in the active loan pool. Of

these, seventy percent (44,948) are subprime ARMs. This amounts to approximately $4.6 billion in subprime ARMs that are set to undergo a rate reset by year-end 2009. This is a worst case scenario, as some of these loans may be paid off instead.

	Origination Year		
	2004	**2005**	**2006**
Active Subprime ARMs	10,824	21,724	12,400
Average Loan Balance Outstanding	$97,583	$103,137	$105,125
Total Loan Balance Outstanding	$1,056,264,154	$2,240,498,682	$1,303,502,904
Projected Reset Year of Subprime ARM Loans Outstanding	2007	2008	2009

Source: First American Loan Performance data (April 2007) obtained from UBS Investment Bank

Tightening of the Mortgage Market

In the case of mortgage interest rate adjustments or unexpected events such as job loss, medical bills, or major life changing events like death or divorce, a borrower can avoid foreclosure either by selling the house or refinancing it. However, having low equity makes the borrower unable to refinance or sell without a significant loss. In Tennessee, almost 48 percent of mortgage holders have 15 percent or less equity in their homes[i]. Although this may pose a risk to the housing market, Tennessee may be considered in better condition compared to high price fluctuation areas such as New York, California, or Florida. In many of the coastal states, especially in recent years, most of the accumulated home equity came from significant home price appreciation. Over the years, home prices in Tennessee increased, but at a rate slower than those states, adding less to home equity through price appreciation.

Population Growth and Migration

Tennessee ranks 12th nationally in population growth (%) since 2000, with a growth rate of 19% between 2000 and 2006. Additionally, over 60% of the total population growth in Tennessee results from migration, yielding higher demand for housing. And, more importantly, nearly 75 percent of migration is internal migration rather than international.

Conclusions

ARMs are a significant and looming problem in Tennessee. However, the housing market, while slowing, is still good. The economy is relatively robust and in the short term looks to remain so. Population growth from internal and international migration will continue as a factor bolstering housing demand in Tennessee. In the absence of a significant decline in home prices, low equity in Tennessee compared with neighboring states does not necessarily represent a lack of investment in properties due to differences between home price appreciation rates.

Outcomes cannot be predicted for subprime ARM borrowers since they do not represent a homogenous group. Market adjustments and reactions are still forthcoming and can go in either direction. However, innovations to address the issue of subprime loans are possible.

A greater understanding of the subprime borrowers will help to develop a more reliable forecast of the sum total of outcomes. More precise projections are possible wherein consideration for additional stratifications at the household level is given. Among the factors influencing the overall market outcome of subprime ARMs in Tennessee include the potential coping ability or lack thereof at the household level. Future analyses could include factors such as households' Income and Wealth, Credit Scores and Debt, Size and Composition, Savings vs. Downpayments, and the Regional and Local Economic Context.

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[i] Cagan, C.L. (2006), "Mortgage Payment Reset: the Rumor and the Reality," *First American Real Estate Solutions*